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ACTIVITIES OF THE UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS AND ITS JOINT UNITS

Experience gained in technical cooperation activities involving assistance in formulating negotiation strategies

Report of the Secretary-General

SUMMARY

The present report provides an analysis of some of the major lessons that have been learned by the United Nations Centre on Transnational Corporations through its technical cooperation programme about trends discerned in strategies adopted by developing countries in negotiating with transnational corporations. The report focuses on two aspects that are always of major concern to developing countries - the sharing of financial benefits derived from the transnational corporations' investment projects and the relationship between transnational corporations' activities and national development policy goals; highlights the growing importance attached to environmental concerns in the negotiating process; and emphasizes the need of developing countries for technical assistance in their formulation of negotiating strategies.

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CONTENTS

	Paragraphs	Page
INTRODUCTION	1 - 4	3
I. DIFFERENT STRATEGIES FOR THE SAME OBJECTIVES	5 - 53	4
A. Fair share of project revenues	7 - 25	4
B. Compliance with national development policy goals	26 - 43	9
C. Prioritization of concern for the environment ...	44 - 53	14
II. CONTEXT OF THE ASSISTANCE PROVIDED BY THE UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS IN CONTRACTUAL NEGOTIATIONS	54 - 56	17
III. CONCLUSIONS	57	18

INTRODUCTION

1. At its seventeenth session, the Commission on Transnational Corporations requested the United Nations Centre on Transnational Corporations to submit a report on the experience gained by the Centre in implementing its technical cooperation programme. The present report responds to that request.

2. So as to define the kind of relationship they wish to promote in their dealings with transnational corporations, developing countries have had to focus on and constantly review three broad areas of interaction: (a) general policy, (b) the legislative framework and (c) investment project negotiations. With regard to policy and the legislative framework, it is now well recognized that the past few years have witnessed a significant change in the attitude of developing countries towards transnational corporations. Various reports have documented the increasing liberalization of the policies and legislative framework of developing countries in their bid to attract more foreign direct investment through transnational corporations. The report of the Secretary-General to the Commission at its sixteenth session on experience gained in technical cooperation activities with respect to the formulation and implementation of foreign investment policies (E/C.10/1990/14, para. 8) gave emphasis to this trend:

> "This change in attitude towards transnational corporations is reflected in official investment policies and in the legislative treatment of transnational corporations by many developing countries in Latin America, Africa and Asia, as well as by certain Eastern European countries. Liberalization has occurred both in those countries that have traditionally been host to transnational corporations and in certain economies that were previously closed to foreign capital. In general, developing country Governments are promoting foreign investment more aggressively than at any time in the past. There is a distinct shift away from rigid regulation and towards policies that are flexible and innovative."

3. It needs to be kept in mind, however, that a host country's liberalization of policies, laws and procedures for dealing with transnational corporations and attracting foreign investment may not materialize in increased inflows of investment if the negotiation strategies adopted by government officials with regard to specific investment projects create disincentives for the potential investors. Furthermore, whatever such inflows may be, the actual benefits gained and the costs incurred therefrom will depend primarily on the negotiation strategy employed by the host developing country in relation to each individual investment project. Thus, an understanding of the effect on developing countries of the recent liberalization of policy and laws affecting foreign investment calls for an examination of whether changes in attitudes of host developing countries towards transnational corporations, as reflected in policy and law, have been translated into the negotiation process.

4. The present report seeks to analyse some of the major lessons that have been learned by the Centre through its technical cooperation programme about the trends discerned in strategies adopted by developing countries in negotiating with transnational corporations. It should be noted from the outset that while the Centre's technical cooperation programme in practice covers a wide variety of sectors, the analysis in this report covers mainly the natural resources sector. The rationale for such an emphasis is that since transnational corporations are in most cases the primary suppliers not only of investment capital but also of know-how, technology and market access, the involvement of those corporations in the natural resources sector is particularly substantial. Furthermore, a large share of requests by developing countries for the Centre's technical assistance is related to that sector. Nevertheless, the present report highlights the essential dimensions of contractual relations involving transnational corporations in all sectors, and it will be evident that both the issues involved and the technical assistance needs of developing countries are in many respects common to all sectors of a developing country's economy.

I. DIFFERENT STRATEGIES FOR THE SAME OBJECTIVES

5. It is the view of many observers of relationships between developing countries and transnational corporations that the era of confrontations has ended. However, a review of the factors that lay behind the confrontations shows that the two basic objectives that developing countries were attempting to achieve then are still very much a part of their strategies today when they enter into contractual relationships with transnational corporations. The first basic objective is, of course, to obtain a fair share of the fiscal take from any particular project; the second is to further certain national development policy goals such as transfer of technology, employment generation, training of nationals, export growth, domestic value added, use of domestic raw materials and forward and backward linkages. Whatever the emphasis or orientation of a particular developing country regarding stated national development policy goals, a basic objective of all such countries is to ensure that transnational corporations' activities in their territories are carried out in a manner that furthers those goals.

6. While these two basic objectives remain as important as they were in the past, what is now new are the different strategies employed by developing countries to achieve the same objectives. What is also relatively new is the prioritization in contractual negotiations of an important policy issue: the requirement that transnational corporations take account of environmental concerns.

A. Fair share of project revenues

7. While a wide range of topics may be covered in any investment project negotiation between a developing country Government and a transnational corporation, the core of any agreement resulting therefrom will be the

division of the project revenues between Government and investor. In the case of developing countries the determination of such a division acquires a special context, especially for projects inherently of long duration. Developing countries want to ensure that the division of revenues remains fair throughout the life of the project. Investors, on the other hand, want to avoid open-ended arrangements in which host countries can, as circumstances may require, alter the types and rates of taxes. The issue then is how to satisfy the legitimate concerns of both parties.

8. Generally speaking, industrialized countries will always provide incentives for attracting foreign investment, on the understanding that they still retain the right to make tax changes as circumstances may require. Although there are some developing countries in a relatively strong bargaining position that can also keep intact their right to make such tax changes, most developing countries cannot attract large-scale investment on the basis of an open-ended fiscal regime. Such investment, if it has a long payback period, is likely to mean that the investing transnational corporation will require contractual guarantees - the so-called fiscal stability clauses - over the life of the project with regard to the applicable fiscal regime.

9. Despite conscious attempts to make their business climate more attractive to foreign investors, many developing countries are still dogged by certain negative but not necessarily correct perceptions of potential foreign investors regarding the stability of their investment regimes. Unfortunately, this situation has in some cases been complicated by political instability, which undermines a coherent and predictable policy environment. Although foreign investors are on average influenced more by economic determinants than by political risk considerations, there is evidence that some investors consider political instability a major disincentive to investment in certain countries or regions (see E/C.10/1990/9, para. 30). Thus for transnational corporations taking what they perceive to be a risk by investing in such an environment, the fiscal stability clauses requirement reflects a cautious approach that they regard as reasonable in the circumstances. The element of caution aside, transnational corporations sometimes argue that even if they were willing to forgo fiscal stability clauses, without the cash flow guaranteed by securing specific undertakings from the host developing country, they still could not raise from their bankers the large capital necessary to finance major projects.

10. While fiscal stability clauses may seem a reasonable requirement to transnational corporations, they can create dilemmas for developing countries. For a long-term project, the Government of a developing country finds itself in the unenviable position of having to accurately assess the yield to be expected from an investment proposal by making predictions of prices and costs 5, 10 or even 20 years ahead. Yet, given the information and technological database available to many of those countries, such an assessment is, in most cases, rather than mere guesswork, at best a gamble.

11. In the case of mining and petroleum projects, Governments are effectively asked to determine the price at which they are prepared to sell their natural resources at a time (prior to exploration) when they usually have no clear idea of the size or quality of the deposit in question. In fact, that situation exemplifies an aspect of bargaining power of which transnational corporations are all too aware. To wait until a commercial discovery has been made before seeking agreement on the fiscal regime would mean loss of the leverage that, prior to exploration, comes from those corporations' assumption of the risk involved.

12. Governments faced with these dilemmas are all too aware of the many cases where, for example, a mine or oil field turned out to be much larger or much more profitable than had originally been anticipated when an agreement with a transnational corporation was signed. The hue and cry thereafter was that those who had negotiated the agreement sold out the country (and included the not-too-infrequent accusation that corruption must have been involved).

13. Such experiences have left many developing countries with the belief that provision for renegotiation should be an essential feature of any satisfactory agreement. While some transnational corporations view the concept of renegotiation as anathema to contractual stability, most of them recognize the validity of the basic reasoning that changing circumstances can indeed turn an agreement into a lopsided arrangement for either party.

14. The necessity of reviewing contracts that have been affected by fundamental changes is recognized in many legal systems, particularly in developed countries. For example, the French doctrine of imprévision and the German doctrine of Wegfall der Geschöftsgrundlage provide for the revision of contracts, in appropriate cases, by reference to objective criteria not traceable to the will of the parties. Indeed, many transnational corporations, whether pursuant to a renegotiation clause or not, frequently request from Governments relief from fixed charges such as royalties and customs duties during times of financial constraint.

15. Developing countries, on the other hand, are keen to enshrine renegotiation clauses in contracts so as to avoid future accusations of attempted expropriation. However, the willingness of transnational corporations to accept renegotiation clauses is usually predicated on the understanding that in the contract appropriate language will be used to eliminate the possibility of either party employing a review clause to implement unilateral changes to that contract. The problem for developing countries is that unless such clauses are very precisely worded situations frequently occur where fundamental changes in economic conditions require some contractual adjustment for the benefit of the developing country but agreement cannot be reached on the kind or level of adjustment required to respond to the changed conditions. Furthermore, even with a renegotiation clause, the constant adjustment and readjustment of contract terms that would be necessary to keep pace with constantly changing economic conditions cannot be fully accomplished under the infrequent periodic reviews afforded by the majority of such clauses. Such shortcomings with respect to these clauses has therefore

meant that some other form of augmentation is necessary for developing countries to fulfil the desired objective.

16. Developing countries have therefore expressed interest in receiving assistance from the United Nations Centre on Transnational Corporations in the negotiation of fiscal regimes that are flexible enough to adjust within the terms of the contract itself to a wide range of economic variables. There are many ways in which such flexibility can be achieved. For example, it may be achieved by using, in the determination of profit shares, a formula based on the relationship between cumulative net cash flows and cumulative capital expenditure. In some other cases, a royalty may be adjustable in relation to a certain factor, such as the price obtained for a mineral. In still other cases physical criteria may be more appropriate; in the oil industry, for example, a variable royalty related to an index of well productivity may be used.

17. In addition to sensitizing the fiscal regime to different economic variables, an important objective of developing countries is to ensure their taking a large share of any excess profit bonanzas, particularly in the case of natural resources. A minimum price at which a given resource can be produced consists of production costs plus some profit level that is sufficient to make the investment attractive. The extra value over and above this minimum price, usually referred to as the economic rent or resource rent, can be viewed as the value of the resource itself which belongs to the community at large. Therefore, once a company has earned a profit that is sufficient to induce it to invest, it should be possible for the host country to take a large part of that extra profit or rent without deterring the investment. This is usually done by applying what is commonly referred to as a resource rent tax or an additional profits tax. 1/ Such a tax is paid only after a certain negotiated threshold rate of return has been earned, and so is charged only on profits that have been earned in addition to the threshold return. The point at which the rate of return has been earned is calculated by compounding (at a rate equal to the threshold rate of return) the project's annual net cash flow for each year in which the compounded net cash was negative and by continuing to do so for as long as the total of that compounded cash flow remains negative.

18. Many of the transnational corporations that accept that upside bonanzas above a reasonable rate of return should be shared with the Government emphasize a parallel need on the downside: providing the investor with fiscal relief under less profitable circumstances even if such a course results in a reduction of the government take. In the spirit of pragmatism evident today, many developing countries have no problem in dealing with this particular concern. 2/

19. In structuring all such fiscal regimes, the aim is to create a flexible tax structure that will, within the ambit of the contract or agreement, also result in a larger share going to the Government if the profitability of the project exceeds expectations. The experience of the Centre has been that transnational corporations are not averse to such a possibility and that many

of them have had the experience in one country or another of operating under a fiscal regime that imposed excess profit taxes. A few are of course reluctant to forgo the prospect of an upside bonanza and in fact view it as a necessary incentive for investment.

20. The imposition of excess profits taxes is common in developed countries. For example, in 1991 the Congress of the United States of America passed a law called the Excess Oil Profits Tax Act of 1991, which imposes a tax of 40 per cent on the excess net profits of large oil companies. The aim was to capture possible excess profits made as a result of oil price increases caused by the Gulf crisis. Under this law, excess net profits constitute excess net income for the taxable year over average annual net income for the period of five taxable years immediately preceding the taxable year in question. Developed countries can easily impose such taxes by legislation when and as appropriate. Most developing countries, however, find that if they are to attract investment, before the start of any pfoject they have to negotiate objective criteria for determining when those taxes can be imposed so as to ensure that no part of the fiscal regime is left open ended.

21. The difficulty, then, for developing countries is to devise the appropriate structure and choose the ideal device from the array of complicated formulas that have been developed around the world. Also a difficult issue is determining a reasonable rate of return for a transnational corporation so as to decide the threshold at which excess profits taxes should be applied. Furthermore, structuring an appropriate fiscal regime of the nature under discussion involves the use of certain economic assumptions in a manner that requires both access to up-to-date economic data and availability of financial analysts able to design the required computer-based models. Yet those data and analysts are frequently in short supply in developing countries although in abundance for transnational corporations. The Centre has endeavoured through its technical assistance programme to fill the gaps.

22. The recent renegotiation of a mining agreement between one African country and a mining company that is a wholly owned subsidiary of a publicly quoted United States transnational corporation provides an example of the use of such technical assistance as is provided by the Centre. The Government of the country in question was seeking modifications to contractual terms last agreed with the company in 1975 and was in particular dissatisfied with the way in which the agreement had been dealing with the allocation of revenues.

23. The Government requested technical assistance from the Centre. In the course of a Centre review of the negotiating positions, it became clear that the Government had been to a large extent working in the dark and that an effective negotiating strategy required a much more detailed knowledge of a whole range of financial matters affecting the future profitability of the project than that with which the government negotiating team was then equipped. The positions taken by the Government appeared reasonable but could not be properly assessed or defended without obtaining the economic data needed for a computer-based fiscal analysis of the project. In the light of that consideration, the Centre advised the Government that further analytical

work should be done to determine the company's financial position and predict the Government's take from the project on a range of possible economic assumptions. On the basis of the relevant financial information, the Centre designed a computer model of the mine. The model enabled the Government, with the assistance of the Centre's experts, to estimate the out-turn of the fiscal regime on various alternative assumptions and was therefore an essential tool in bargaining sessions with the company.

24. The fiscal regime agreed between the Government and the company was complex and no attempt to provide a comprehensive analysis will be made here. However, the main elements included (a) mining lease rent and surface rent, (b) an adjusting royalty, (c) an income tax and (d) an additional profits tax. The additional profits tax in particular was designed to respond to the desire of the Government to have a meaningful share of any especially large profits that might accrue should mineral prices rise very sharply.

25. Despite misgivings about long-term commitments, the trend seems to be that most developing countries are willing to provide the necessary contractual undertakings for fiscal stability. In providing contractual undertakings aimed at ensuring that no significant part of the fiscal regime remains open-ended, there are, however, two matters that developing-country Governments insist transnational corporations must keep in mind. First, the undertakings must be in a form consistent with the host country's legal and constitutional requirements. Thus, for example, in countries whose constitutions enshrine parliamentary sovereignty, the Government cannot give binding commitments that would imply that parliament cannot in future adjust or raise taxes. 3/ Secondly, contractual undertakings for stability should not extend beyond the specifics of the fiscal package. Developing-country Governments are not willing to take the position that if, for example, future legislation on social or environmental issues results in an increase in business costs, any particular investor should be exempted from making its contribution to the cost of general development while the other members of society carry this burden. 4/

B. Compliance with national development policy goals

26. The capacity to formulate and ensure the promotion of national development policy objectives is of fundamental importance to any Government. In this respect, developing countries have sometimes viewed transnational corporations as a threat. Such corporations are seen as having the ability, through the control of strategic or key sectors of the economy, to affect, in one way or the other, the Government's development objectives and to have an impact that may be contrary to government policy. For many developing countries, equity participation was seen as the avenue for ensuring that transnational corporations behaved in conformity with government objectives. Because Governments of those countries assumed that through such participation they would gain an effective say in managerial decisions. This view was one of the primary catalysts to the partial or full nationalization of transnational corporation investments and also one of the reasons for barring or restricting new foreign investments in terms of specified shareholding percentages.

27. Over the past decade, developing countries have made extensive policy changes in the areas relating to entry and ownership requirements. Those countries recognize that acquiring part ownership in ventures with transnational corporations does not guarantee a say in all of the decision-making process. The experience of countries that have taken an interest in many mining or petroleum projects shows that the investor will require a veto over important policy decisions and that some basic management prerogatives must remain intact. In fact, transnational corporations may effectively control an operation without even holding majority ownership because of their access to foreign markets and the relevant technology. Besides (except in the natural resources sector, where a number of agreements provide for "free equity" for the Government), many developing countries have gone through painful lessons of being burdened by heavy commercial debts acquired for the purpose of buying equity in ventures from which they have in the end realized no benefits commensurate with the debt they now carry.

28. The recognition by developing countries that equity participation is not a must for achieving their objectives has affected their attitudes not just to future investments. Today, a number of developing countries are in the process of generally redefining the role of the State in the economy. Indeed, many are moving in the direction of becoming more facilitators and regulators of productive activities and less direct producers and suppliers of goods and services. To this end, Governments are engaged in the sale of State-owned companies to the private sector and are prescribing that State-owned companies should subcontract to private companies an increasing share of activities related to the production and supply of goods and services. Due to a number of factors, including the unavailability of a well-developed private entrepreneurial class and the weakness of the local capital markets, privatization programmes in developing countries have significant involvement of foreign transnational corporations. The Centre is therefore increasingly called upon to assist Governments in negotiating the relevant terms, including in a number of cases debt equity swaps.

29. Despite the disappointments from equity participation, developing countries still seek to regulate the activities of transnational corporations to ensure that such activities are consistent with national development goals. Governments are therefore shifting from entry and ownership restrictions to the prescription or negotiation of performance targets and their effective monitoring. In assisting developing countries to formulate legislation or negotiate contracts, the Centre has often demonstrated that where there is a proper regulatory scheme embodied in legislation or a contractual agreement, any additional leverage resulting from equity participation is likely to be of only marginal importance and that if effectively monitored, such schemes can provide the adequate control required. Over time, most developing countries have come to the conclusion that equity participation is not necessarily an effective means of achieving control.

30. A legislative scheme of the kind mentioned above was recently formulated, with the assistance of the Centre, by one East African country for its mining sector. Among other things, the legislation will:

(a) Give the Government, through the issue and renewal of prospecting or exploration licences, regulation of the exploration programme by establishing work programmes and minimum expenditure requirements;

(b) Ensure, through the operation of the licensing system and mandatory area relinquishment provisions, a measure of control over the pace of exploration;

(c) Secure for the Government, through reporting requirements imposed on licensees, a flow of accounting and financial data, as well as of geological and geophysical data;

(d) Secure for the Government, at the time when a commercial deposit has been identified, a substantial measure of decision-making power over mining operations, through the requirement of submission of a development plan containing proposals for development and mining and its approval by the Government;

(e) Maintain a continuing measure of regulatory powers during the course of mining operations, through the implementation of the proposals for development and the need for government approval before any major changes can be made in those proposals.

31. The same kind of detailed level of regulatory control can also be achieved under the contractual arrangement itself. Many petroleum or mining agreements specify that the foreign investor will submit to the Government proposals for the construction, establishment and operation of petroleum exploitation or mining facilities, covering specific matters set out in the agreement. The agreement then establishes a procedure for the Government's approval of the proposals submitted and for the resolution of any differences that might arise in connection with them. Once the proposals are approved, the investor is bound by contract to carry out the project, substantially in accordance with the approved proposals. Variation in the approved proposals would require further approval from the Government under a procedure established in the agreement.

32. Regulatory schemes of the kind described above are sometimes criticized by transnational corporations as creating the possibility of imposing unnecessary managerial rigidity on their projects. Those corporations complain that if anticipated circumstances subsequently change, the whole project may be put in jeopardy by the difficulty of reaching agreement with the Government on an appropriate modification of the proposals originally agreed. While most of this criticism is not justified (as evidenced by the fact that very few projects in developing countries have actually aborted as a result of failure to reach agreement on an appropriate development plan), it nevertheless reflects the reasons why developing countries in their bid to be attractive to foreign investors sometimes have difficulties in determining the extent of the regulation they should impose. This is thus an issue on which the Centre is frequently called upon to provide advice.

33. In providing assistance to developing countries formulating sector-related legislation the Centre has observed those countries practising two contrasting styles. Some countries have taken the course of enacting highly comprehensive laws that, in either the law itself or regulations made under it, provide in detail for a great many of the issues that arise in the course of operations carried out by the investor in a particular sector. At the other end of the scale are some statutory schemes that are no more than a loose framework, leaving most of the detailed questions to be regulated by the terms and conditions set out in licences or agreements. Advantages and disadvantages are connected with either course of action.

34. The most significant advantage of enacting a detailed regulatory scheme is that in terms of the Government's own choosing it limits the scope of the matters that have to be covered in negotiations between the Government and the foreign investors. Most transnational corporations, if they are faced with legislation that has been carefully drafted with due regard to established practices in a particular industry, will take the law as they find it. Some provisions may be regarded as unnecessary or irksome but because they are in the law they will be accepted. Similar provisions if they appeared in a model agreement or a government draft put forward in negotiations at large, could result in prolonged, time-wasting discussion.

35. By the same token, however, the enactment of a detailed legislative scheme introduces for both sides an element of inflexibility. Unless the requirements imposed on investors are somewhat minimal, there is in practice a danger that standards will be set at a level that could, in particular cases, act as a serious disincentive to investment. A developing country wishing to attract investment to a particular sector must set terms that correctly reflect the country's current standing in the market. In practice, however, it is not always easy to set such terms (unless the developing country is in an unusually strong bargaining position) without first testing and probing the basic elements of a deal in properly conducted negotiations. 5/

36. The Centre has encountered situations where Governments have little choice in the short term but to rely upon contracts rather than detailed legislation. Such cases arise especially in newly opened economies where the absence of private investment activity has resulted in the fossilization of core commercial legislation and of the relevant sectoral legislation to the degree that that legislation has to be extensively supplemented by contractual provisions covering what would otherwise be taken for granted under modern legislation. Such contracts will contain, for example, not just rates of income tax but detailed rules for the computation of taxable income. The same situation arises in a number of developing countries where commercial legislation is virtually unchanged from colonial times. There are even cases in former centrally planned economies where such legislation has been abolished altogether.

37. In such cases Governments have had to proceed with comprehensive contracts rather than await the elaboration of fully fledged legislation. The Centre has assisted such Governments in drafting model contracts that enable a

degree of consistency in their approach to be established from the start. However, the Centre advises such Governments that ultimately, when investment interest accelerates, the contract-by-contract approach will not be sustainable administratively. It becomes evident that workable general legislation is necessary, and unless the Government has strong reasons for retaining scope for bargaining over general issues such bargaining is increasingly restricted to project-specific matters.

38. Flexibility and the capacity to adjust quickly to a perception of market forces are the most significant advantages of regulating transnational corporations' operations with a law that provides only a framework (to be amplified in matters of detail by the publication of a model agreement), but the extent to which model licences or model agreements have to be adapted in the course of negotiations will very much depend on the bargaining strength of the country concerned. The petroleum sector provides good examples of these considerations. The model licences set out in the Petroleum Production Regulations of the United Kingdom of Great Britain and Northern Ireland can by law be modified by the Secretary of State but in actual fact modifications take place rarely and only in very special circumstances. That the model clauses set out in the Regulations are therefore indistinguishable in practical terms from a statutory provision set out in a law or in delegated legislation is a reflection of the strong bargaining position of the United Kingdom in dealing with oil companies. For most developing countries, with a much weaker bargaining position, the situation is somewhat different. In publishing a model agreement or a model licence, a developing country must generally anticipate (unless it has a well-established petroleum sector) that modifications - and sometimes substantial ones - may be necessary before agreement can be reached with private sector oil companies on a major investment in exploration.

39. Because of the uncertainty of developing countries being able to sustain a policy framework set out in a model agreement or licence, the Centre has advised a number of them to compromise by adopting what might be described as a mixed or hybrid system. Within that system certain basic provisions are set out in a law of general application that stipulates the minimum terms and conditions that must be satisfied by applicants for the grant of exploitation rights. At the same time the system allows for key matters to be settled in agreements. Matters dealt with in an agreement would generally include minimum work and expenditure obligations, some elements in the fiscal regime that will determine the final division of profits generated by the project and the methodology for dispute settlement.

40. Whatever form or method a Government chooses for providing the regulatory framework for transnational corporations, an important factor that has to be kept in mind is the ability to monitor compliance with such obligations as may be prescribed. In their attempts to formulate the most effective contractual provisions, many developing countries have unfortunately sometimes ended up with contractual arrangements that constitute an administrative nightmare for the officials involved in their monitoring and compliance.

41. In one example, the Centre recently advised a Government involved in a protracted foreign exchange dispute with one of the country's principal foreign investors concerning the issue of the investor's adherence to contractual foreign exchange arrangements over a lengthy investment recovery period. The dispute had been unresolved for several years and entailed a very substantial sum. One of the major problems was that the underlying conctractual conception had led to a set of rules far too complex to administer properly within a rapidly changing economic climate.

42. A discussion paper prepared by the Centre for a meeting dealing with the petroleum sector in Asia and the Pacific 6/ put the problem of the complexities of monitoring in the following terms:

> "The ability to administer petroleum agreements is often an issue that does not receive the proper attention it deserves. In many cases, new laws, regulations or contracts are introduced on the assumption that administrative capabilities will somehow be developed in the future. But more often than not, this does not turn out to be the case. There is a need therefore to make concerted efforts to bring about a better balance between administrative capabilities and the complexity of petroleum arrangements."

43. Not too infrequently, however, lapses in monitoring efforts occur that are not a result of complex arrangements. In providing technical assistance to developing countries, the Centre's experts have come across situations where difficulties arose as a result of Governments not exercising their contractual rights of monitoring compliance on an ongoing basis. Instead, those Governments dusted off and analysed the relevant contracts only in the event of significant infringements of the obligations of transnational corporations. In one recent case of contract renegotiation with a transnational corporation, one of the issues about which the Government in question was dissatisfied was its inability to have more access to the decision-making process regarding the transnational corporation's activities. Interestingly, however, under the provisions of the agreement that was being renegotiated, the Government had had for some years the right to appoint two directors to the board but had not in fact done so. Following inquiries by the Centre, it turned out that government authorities had actually not been aware of having that right - a clear example of the case where contractual provisions may prove to be ineffective only for lack of monitoring or enforcement.

C. Prioritization of concern for the environment

44. Until quite recently, an assessment by developing countries of the impact of activities of transnational corporations on the natural environment took a secondary if not marginal role in project planning. For many of the developed country-based transnational corporations seeking to realize the cost advantages of relatively less demanding environmental standards in developing countries, maintaining those lower standards was a deliberate objective in the

negotiations of contractual commitments. The situation was exacerbated in some developing countries by Governments that, in making a drive towards attracting foreign investment in an increasingly competitive climate, found themselves confronted with the difficult choice between approving environmentally substandard projects that could provide badly needed financial benefits for their countries and rejecting such benefits because of the long-term socio-economic costs. Many Governments chose the former course.

45. However, the recent world-wide focus of attention on environmental issues, as well as the tragic experiences of some developing countries arising out of environmental disasters caused by transnational corporations' activities and subsequent difficulties in allocating liability and costs, has pushed environment management and protection to the forefront of project planning. While developing countries' policies are now oriented towards taking into account factors related to the environment, problems still remain on how to formulate, in relation to individual projects, the necessary contractual stipulations.

46. In dealing with transnational corporations, the environmental policy expectations of the host country may be expressed in the country's legislation, in a particular investment project contract between the country and the transnational corporation or in both legislation and a contract.

47. Many developing countries do not have legislation specifically targeted on environmental protection. However, most of those countries do utilize provisions in sector-oriented legislation for the purpose of setting environmental goals with reference to the particular sector. Although such provisions do not prescribe precise standards of environmental quality to be attained, they do set the basic criteria that must be translated into environmental protection measures during the actual negotiation and formulation of investment project proposals. Such an approach has certain advantages. For developing countries that have not yet formulated a comprehensive policy on environmental issues, using contracts to stipulate specific environmental provisions offers an opportunity to set environmental standards that are adapted to the technical and ecological particularities of each investment project without the need to go through cumbersome legislative procedures.

48. However, the approach of simply providing general criteria in sectoral legislation can also be disadvantageous to a developing country. The Centre's experience with these criteria indicates that there can be a wide range for discretion in their application, which may result in the defeat of the intentions of the legislature that formulated them. The translation of general legislative provisions into practical decisions in the course of contract negotiation may require an element of bargaining about issues that should otherwise not be debatable.

49. The negotiation of mining or petroleum agreements has a special dimension that affects the content of environmental provisions included in the contract. It is important from the point of view of both parties that the

content and scope of the provisions dealing with environment be tailored to the needs of the individual mine or petroleum field under consideration; but if negotiations are carried out prior to exploration, such individualized adaptation must remain incomplete since much of the required data are not yet available at that stage. Thus, in most of the recent agreements entered into between developing countries and transnational corporations, the investor is required, on making a discovery, to supplement the mining or petroleum development plan with a comprehensive environmental impact study. For the host country, such open contractual stipulations have the advantage of postponing the specification of environmental requirements until a clear, accurate assessment of information needs can be made. For the investor, however, such regulation may pose the disadvantage of setting no definite limits to the costs of development.

50. Aside from the uncertainty about costs, an even more worrisome problem (from the point of view of the investor who has spent huge sums of money at the exploration stage) is the possibility that investor and host country, taking into account the results of the environmental impact study, may fail to reach agreement on whether the investor's development proposals are environmentally sound or not.

51. In anticipation of possible failure to reach agreement on environmental protection measures, some Governments insist that agreements expressly draw environmental criteria into the approval process for the project. In such cases, the minister responsible may make known to the investor certain objections to the investor's plans or designs relating to the project, with the Government's reserving the right to withhold its approval of plans and designs that may unreasonably damage the surrounding environment, limit its further development potential or significantly disrupt socio-political stability in the area. Provision is usually made to ensure that such approval shall not be unreasonably withheld or delayed.

52. Setting environmental standards without providing adequate enforcement procedures could be a wasted effort. Various forms of enforcement provisions relating to the environment are therefore now becoming a standard feature of agreements negotiated between transnational corporations and developing countries. Such provisions mainly consist of environmental reporting requirements and government inspection rights.

53. The monitoring of the environmental effects of operations of transnational corporations must of course be complemented by the provision of sufficient coercive means to ensure adherence to set standards. The problem is that coercive measures prescribed under the legislation of most host developing countries generally provide protection only in cases where the natural environment or the resource in question is significantly endangered. Thus in negotiating individual contracts, developing countries now seek to provide for additional measures that will allow their enforcement authorities to ensure ongoing compliance with the prescribed environmental standards. In particular, such provisions empower government authorities to carry out necessary remedial and protection measures at the expense of the investor. 7/

Provision may also be made for the investor to furnish a security deposit that can be used by the host country to fund the remedial and protection measures undertaken by the government authorities.

II. CONTEXT OF THE ASSISTANCE PROVIDED BY THE UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS IN CONTRACTUAL NEGOTIATIONS

54. It could be assumed that the now-perceived demise of the era of confrontation between developing countries and transnational corporations might imply a drastic reduction in contentious issues and a corresponding lessening need on the part of developing countries for technical assistance in their contractual negotiations with transnational corporations. The Centre's experience indicates, however, that the reverse is true. The new pragmatism exhibited by developing countries in dealing with transnational corporations has certainly been an eye-opener for those corporations with respect to the previously unused or underutilized options (of the kind described in this report) that developing countries can employ in their attempts to protect their interests while attracting foreign investment. However, while developing countries are willing (at the policy level at least) to put to maximum use development of the wide range of different schemes that offer alternatives for achieving their objectives, they are still keenly aware that if their government officials involved in specific negotiations are to take full advantage of those schemes - with a proper understanding of their financial, legal and technical implications - complementary outside expertise remains extremely important. The Centre's technical assistance programme has felt a high demand for such expertise and continues to feel it.

55. It should be noted that with regard to any specific negotiation between a developing country and a transnational corporation for which technical assistance is provided, the Centre's role is to advise and assist the Government. The Centre avoids, of course, any possibility of being viewed or even portrayed as a party to the negotiations and thus neither takes positions of its own in those negotiations, nor seeks to act as a mediator. Characteristically the Centre's experts work with a team of government negotiators under the leadership of a senior government official. Thus, the contractual arrangement that results from any such negotiation will reflect the particular country's own orientation and attitude towards transnational corporations and foreign investment.

56. In the course of providing assistance to Governments, the Centre of course sometimes encounters the well-known rivalries between different government departments and the promotion of self-interest by each of them, especially in countries where State-owned enterprises are involved in or have a monopoly over the relevant sector. In such cases, a particular department may propose, for example, that most of the revenues to be derived from a particular project be received in the form of royalties (to be collected by that department), while the income tax department would prefer to collect those revenues as income tax. Although the Centre does not act as arbiter to

such disputes, the independent opinion provided by the Centre usually gives a considerable measure of comfort to the decision makers when they finally have to make their choices.

III. CONCLUSIONS

57. The analysis in this report of some of the negotiating strategies now adopted by developing countries indicates that new forms of contractual relationships have emerged that have an inbuilt element of fiscal regime durability and can meet compliance and monitoring requirements of developing countries without such countries imposing on themselves unnecessary financial burdens related to acquisition of equity. Concern for the environment has also been shown to be an increasing priority for developing countries in the formulation of contractual relationships with transnational corporations. Against this background, the necessity of having continuous access to up-to-date information and data on legal, economic, financial and fiscal matters, in order to structure an appropriate contractual framework, has been emphasized. The importance of having available relevant expertise for the design of fiscal regimes and the evaluation of alternative proposals made during the course of negotiations has also been pointed out. Yet, it is in these areas that developing countries still face serious limitations. Efforts by the international community to provide assistance should therefore remain a priority if the pragmatism exhibited by developing countries in adopting innovative measures is to bear fruitful results. In that regard, the technical assistance programme of the United Nations Centre on Transnational Corporations has been adapting continually to respond to the changing needs and priorities of developing countries.

Notes

1/ For a detailed exposition of the concept, see Ross Garnaut and Clunies Ross, Taxation of Mineral Rents (Oxford, Clarendon Press, 1983) and Christopher Goss, Petroleum and Mining Taxation: Handbook on a Method for Equitable Sharing of Profits and Risk (London, Royal Institute of International Affairs, 1986).

2/ Legislation in many developing countries provides for the remission of royalties in such circumstances. See, for example, the Uganda Petroleum (Exploration and Production) Act (1985), sect. 48.

3/ However, the agreement may provide that where such tax increase adversely affects the investor, (a) other parts of the fiscal regime will be adjusted in order to ensure that there is no effective change for the investor or (b) that increase will be paid by a State entity on behalf of the investor.

Notes (continued)

4/ Where a transnational corporation is concerned that such social legislation may be used to target it for payment of all such costs, especially in a poor or small country with a single large foreign investment project, contractual guarantees may be provided to ensure that that legislation will not be discriminative.

5/ One West African country has requested the Centre's technical assistance in drafting a new mining law based on that country's experience in recent negotations with three mining companies.

6/ United Nations Centre on Transnational Corporations/United Nations Development Programme Asia-Pacific Round Table on Fiscal and Administrative Strategies for Petroleum Exploration and Development, held in Kuala Lumpur, Malaysia, from 16 to 18 September 1991.

7/ See clause 10 (k) of the Sierra Leone-Sierra Rutile Agreement, 1989.